



November 7, 2006

Mr. Richard Krolak
Chief, CalPERS Office of Long Term Care
400 P Street, 5th floor
Sacramento, CA 95814

Subject: CalPERS LTC Program – Revised Proposed Mitigation Plan

Dear Mr. Krolak:

The purpose of this document is to present both updated and additional data/information relating to specific proposed mitigation initiatives presented and discussed at recent Advisory Committee and Health Benefits Committee meetings. Please note that the information presented here is based on our 2006 valuation results.

Proposed Mitigation Plan

Based on updated valuation results, subsequent discussions with CalPERS staff and feedback received during recent Advisory Committee and Health Benefits Committee meetings, we propose the following mitigation approach for review and consideration:

- Based on 2006 base case valuation results and targeting a 0% margin, the projected funding deficit as of 6/30/06 is approximately 36.8%.
- We account for the projected impact of future new business by assuming that 2005 premium production would continue for the next ten years.
- We account for 2.5% of additional future morbidity improvement identified by LTCG staff.
- Given all of the above, we calculate the aggregate rate adjustment for LTC-1 and LTC-2 policies (i.e., for 2004 and prior issues) that, when combined with the other items outlined above, is projected to result in the target funding level.
- We develop a rate adjustment scenario by plan using 2006 rate relativities and assuming that the needed aggregate rate adjustment would be implemented through either a one-step process effective 7/1/07 or a two-step process effective 7/1/07 and 7/1/08.

Attachments 1 and 2 summarize all of the above.

While the above would lead to a break-even projection given our valuation results, it would result in a 5% margin given Mercer's valuation results.



Please note that, as labeled, the proposed rate adjustment scenario relates only LTC-1 and LTC-2 policies. In the aggregate, projection results for LTC-3 policies (i.e., 2005 and 2006 issues) appear to break even and contribute to surplus, respectively, without any revisions.

Socialization Scenarios

A variety of socialization scenarios by plan and/or issue-age have been discussed relating to the proposed rate action

Attachment 3 summarizes proposed rate increase percentages and corresponding ultimate monthly premium increase amounts by plan for a typical maximum daily benefit amount (i.e., \$130 per day) without socialization by issue-age. Attachment 3(a) assumes a one-step rate increase implementation, while Attachment 3(b) assumes a two-step implementation.

Attachment 4 summarizes proposed rate increase percentages and corresponding ultimate monthly premium increase amounts by plan and issue-age for a typical maximum daily benefit amount given moderate socialization by issue-age. Attachment 4(a) assumes a one-step rate increase implementation, while Attachment 4(b) assumes a two-step implementation.

Attachments 5(a) and 5(b) summarize proposed rate increase percentages and corresponding ultimate monthly premium increase amounts associated with one-step and two-step implementation plans, respectively, by plan and issue-age for a typical maximum daily benefit amount given the following socialization parameters proposed by the LTC Advisory Committee:

- Identical percentage increases across all plans;
- A minimum increase for all plans of \$10 per month; and,
- A maximum increase for persons age 75 and older of 10% or \$100 per month, whichever is lower.

Please note that the above were assumed to apply to individuals whose initial daily benefit was \$130 per day (consistent with Attachments 3 & 4), and that the flat-dollar parameters outlined above would be applied proportionately to those with alternative daily benefit amounts.

As you can see, these parameters lead to increases by age that would shift the funding burden (as a percentage of current premiums) significantly towards the younger ages.

Resulting Rate Comparisons

Attachments 6 through 8 (updated versions of an attachment previously provided) are competitive comparisons summarizing estimates of inforce program rates assuming that

ultimate rate increases are implemented consistent with those summarized on Attachments 3 through 5, respectively.

Please note that Attachments 8(a) and 8(b), while demonstrating the extreme subsidization by plan and issue-age in this scenario, do not fully demonstrate the impact of the proposed subsidization at the youngest ages as it only includes issue-ages down to 50. The comparisons would look worse for issue-ages below 50.

Please note that we would not recommend pursuing this last scenario because it would lead to a rate structure that would discourage younger enrollees and those with lesser benefit plans from remaining in the program.

Follow-Up Items

For your information, the following items still need to be addressed:

- We have not yet made any explicit provision for the impact of plan migration.
- We have not yet thoroughly identified those eligible (i.e., there are lower benefit options available) and able (i.e., the lower benefit options actually lead to premium decreases) to buy-down benefits in conjunction with the proposed rate increase.
- After all adjustments have been finalized, we will need to “rebalance” the results to ensure that target projected revenue amounts are achieved.

We will work through all of these items during the implementation process.

Regarding the second bullet above, we have worked through a preliminary analysis comparing post-increase inforce lifetime benefit period rates under the various scenarios against current new business rates for corresponding 6-year benefit period plans, and it appears that downgrading from an existing lifetime benefit period policy to a 6-year benefit period policy in order to save premium dollars could be a viable option for many. The extent to which this would be true depends upon which rate increase scenario is adopted.

Please note that our analyses assume that administrative expenses are consistent with valuation assumptions. To the extent that they are not (e.g., administrative expenses increase significantly due to complicated mitigation scenarios), our analyses might need to be revised.

A Note Regarding Implementation

As indicated previously, based on my experience, regardless of the mitigation plan agreed upon, we will not be able to identify or understand all of the issues involved with the plan until we begin to work through the implementation process. Given that, I would recommend that any decisions made by the Advisory Committee or the Board be open-

ended enough to allow for adjustments that are consistent with original intent. Of course, any adjustments would be subject to approval as well.

Please note that we have worked through a preliminary review of all inforce rates and we are comfortable that we understand, for the vast majority of inforce policies, the source(s) of those rates. As a result, we should be able to predict the impact of any proposed rate actions on policies inforce as of the implementation date.

Regarding the implementation of the 2007 Benefit Increase Option (BIO) and the interaction of that process with a rate increase implementation process, regardless of whether the BIO is implemented before or after the rate increase, the premiums associated with the BIO should reflect post-increase rate levels.

Benchmarking, Measurement and Reporting

As also mentioned in my last letter, regardless of what plan is agreed upon and implemented, care should be taken that the appropriate benchmarks are set, measurements are in place, and reporting takes place so that those responsible for managing the program will have the data/information they need to understand how the program is progressing in relation to the plan established.

Caveats and Limitations

All caveats and limitations from the 2006 valuation also apply to this letter and any other related analyses, correspondence, etc.

Conclusion

Please feel free to contact me with questions/comments regarding anything presented to date at (317)575-7672 or via e-mail at kvolkmar@uhasinc.com.

Sincerely,

A handwritten signature in black ink, appearing to read 'Karl G. Volkmar', with a stylized, cursive script.

Karl G. Volkmar, FSA, MAAA, FCA
Principal & Consulting Actuary

Attachment 1

Attachment 1

CalPERS LTC Program Summary of Proposed Mitigation Scenario

Needed One-Time Increase @ 7/1/06:	36.8%	Aggregate Increase Including 0% Margin
Less Impact of New Business:	3.9%	Assuming 2005 Premium Production for 10 Years
Less Impact for Claims Management:	<u>5.3%</u>	Assuming 2.5% Savings in Future Paid Claims
Adjusted One-Time Increase @ 7/1/06:	27.6%	
Corresponding Adjusted One-Time Increase @ 7/1/07:	32.6%	
Adjusted for Implementation on LTC-1 & LTC-2 Only:	33.6%	

Note: Please see Attachment 2 for information regarding rate increases by plan using a specified implementation strategy

Attachment 2

Attachment 2

CalPERS LTC Program Summary of Proposed Rate Adjustment Scenario By Product for LTC-1 & LTC-2

Plan	Aggregate Increase to 2003 for 2005	Aggregate Increase to 2005 for 2006	Aggregate Increase to 2003 for 2006	Proportionate One-Time Increase as of 7/1/07	Revised Proportionate One-Time Increase as of 7/1/07	Corresponding Two-Step Implementation: 7/1/07 & 7/1/08	Corresponding Ultimate Increase
CLi	45.5%	4.2%	51.6%	39.0%	39.0%	18.9%	41.5%
CL	50.9%	0.0%	50.9%	38.5%	39.0%	18.9%	41.5%
C3i	5.3%	15.8%	21.9%	16.5%	16.5%	8.4%	17.5%
C3	5.3%	0.0%	5.3%	4.0%	5.0%	2.6%	5.3%
NLi	41.7%	4.2%	47.6%	36.0%	39.0%	18.9%	41.5%
NL	65.8%	0.0%	65.8%	49.8%	39.0%	18.9%	41.5%
N3i	5.3%	15.8%	21.9%	16.5%	16.5%	8.4%	17.5%
N3	5.3%	0.0%	5.3%	4.0%	5.0%	2.6%	5.3%
P2	5.3%	17.1%	23.3%	17.6%	16.5%	8.4%	17.5%
P1	0.0%	7.9%	7.9%	6.0%	5.0%	2.6%	5.3%
Total	38.5%	4.3%	44.4%	33.6%	33.6%	16.5%	35.7%

Plans

CLi	= Comprehensive, Lifetime Benefit Period, With Inflation
CL	= Comprehensive, Lifetime Benefit Period, Without Inflation
C3i	= Comprehensive, 3-Year Benefit Period, With Inflation
C3	= Comprehensive, 3-Year Benefit Period, Without Inflation
NLi	= Facilities-Only, Lifetime Benefit Period, With Inflation
NL	= Facilities-Only, Lifetime Benefit Period, Without Inflation
N3i	= Facilities-Only, 3-Year Benefit Period, With Inflation
N3	= Facilities-Only, 3-Year Benefit Period, Without Inflation
P2	= Partnership, Comprehensive, 2-Year Benefit Period, With Inflation
P1	= Partnership, Comprehensive, 1-Year Benefit Period, With Inflation